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Supreme Court, U. S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1975

**No. 75-.....**

ALLIS-CHALMERS MANUFACTURING COMPANY,

*Petitioner,*

—v.—

GULF & WESTERN INDUSTRIES, INC.,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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GULF & WESTERN INDUSTRIES, INC.,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Allis-Chalmers Manufacturing Company ("Allis-Chalmers") prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on September 29, 1975.

### Opinions Below

The opinion of the United States Court of Appeals for the Seventh Circuit, rendered on September 29, 1975 and as yet unreported, is set forth in Appendix A hereto. The opinion of the United States District Court for the Northern District of Illinois is reported at 372 F.Supp. 570 (N.D. Ill. 1974), and is set forth in Appendix B hereto.

## Jurisdiction

The judgment of the Court of Appeals was entered on September 29, 1975. Prior to the entry of judgment, the Court of Appeals *sua sponte* circulated the opinion among all the active judges of that court because, as was candidly acknowledged, the court "adopt[ed] a position on an issue as to which a conflict between circuits exists". 6a n.5.* A majority of the active judges did not request rehearing *en banc,* Chief Judge Fairchild and Judge Cummings voting for rehearing. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

## Statute Involved

Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b), provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of

* Citations to "__a" are to the Appendices attached hereto.

not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

## Question Presented

Is the purchaser of approximately 29% of the registered equity securities of an issuer, who prior thereto owned no such securities but who within six months after the purchase "voluntarily disposes of" the securities, liable under Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b), to the issuer for all short-term profits realized?

## Statement of the Case

Petitioner Allis-Chalmers is a Delaware corporation whose common stock was at all relevant times registered pursuant to the provisions of Section 12 of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78 l.

Respondent Gulf & Western Industries, Inc. ("Gulf & Western"), also a Delaware corporation, is a conglomerate which "had bought and sold controlling interests in a number of corporations" prior to its initial purchase of Allis-Chalmers stock. 2a n.1.

In May 1968 Gulf & Western was interested in acquiring a substantial portion of the outstanding common stock of Allis-Chalmers. Respondent's chairman, Mr. Bludhorn, and president, Mr. Judelson, notified the chairman of Allis-Chalmers, Mr. Stevenson, that respondent was considering acquiring stock in petitioner by means of an exchange, and the next day informed petitioner that Gulf & Western would seek to effect the purchase of 3,000,000 shares of Allis-Chalmers stock by means of an exchange offer.

On July 1, 1968 respondent formally offered to purchase 3,000,000 shares of Allis-Chalmers common stock for a package of cash, subordinated debentures and warrants. These 3,000,000 shares represented approximately 29% of the then outstanding Allis-Chalmers common stock. The exchange offer was fully subscribed to on July 19, 1968, and respondent's shareholders approved the offer on July 29, 1968. Prior to its purchase of these 3,000,000 shares of Allis-Chalmers, Gulf & Western owned none of petitioner's common stock.

Subsequent to the purchase of this 29% block of Allis-Chalmers common stock, respondent entered into an agreement in August 1968 with Oppenheimer Fund, Inc. ("Oppenheimer") whereby respondent would acquire an additional 248,000 shares of Allis-Chalmers common stock held by Oppenheimer. Gulf & Western's purchase of this block of stock occurred on September 30, 1968.

In the period subsequent to its agreement to acquire the second block of Allis-Chalmers common stock, respondent underwent a change of heart as to the attractiveness of owning 3,248,000 shares of Allis-Chalmers stock. The Court of Appeals wrote:

> "On September 13, 1968 Allis-Chalmers chairman Stevenson had on his own initiative met with Bludhorn and Judelson of Gulf & Western and had, according to his recollection at trial, told them that things did not look good for Allis-Chalmers. He refused to quantify the bad news for the Gulf & Western representatives in response to their specific questions, but he clearly disclosed to them his personal negative evaluation of the situation at Allis-Chalmers. Stevenson's notes for this meeting reflected his belief at that time that the Gulf & Western people were 'getting nervous' about their block of stock in Allis-Chalmers. At trial, Stevenson testified that he 'had the feeling right then [at the September 13, 1968 meeting] that they were thinking about disposing of it." 4a n.4.

On the very day of its purchase of the block of Allis-Chalmers stock from Oppenheimer, Gulf & Western commenced negotiations with White Consolidated Industries, Inc. ("White") for the sale to White of the entire block of 3,248,000 Allis-Chalmers shares owned by respondent.

On October 31, 1968 respondent and White reached agreement, and on December 6, 1968 Gulf & Western sold its entire block of 3,248,000 shares of Allis-Chalmers stock to White. Therefore, within a period of less than six months, Gulf & Western had first purchased in two large blocks and then, after apparently "getting nervous" over the prospects of Allis-Chalmers, sold in a single transaction 3,248,000 shares of Allis-Chalmers registered common stock.

## The Decision of the District Court

On January 6, 1969 petitioner commenced suit against Gulf & Western, pursuant to Section 27 of the 1934 Act, to recover pursuant to Section 16(b) the short-swing profits that Gulf & Western realized on the two purchases and single sale within less than six months of 3,248,000 shares of Allis-Chalmers common stock. A non-jury trial resulted in a judgment against Gulf & Western in the amount of $1,135,838, the amount the District Court calculated to have been Gulf & Western's profits on the two purchases and single sale of all 3,248,000 shares of Allis-Chalmers stock. The District Court held that respondent was a "beneficial owner" within the meaning of Section 16(b) when it made its initial exchange offer purchase of approximately 29% of petitioner's common stock, and, in accord with rulings of the Courts of Appeals for the Second and Eighth Circuits and decisions of this Court, construed the proviso of Section 16(b) exempting "any transaction where such beneficial owner was not such both at the time of purchase and sale" as not applying to Gulf & Western's initial purchase of more than 10% of the listed equity securities of Allis-Chalmers.

## The Decision of the Court of Appeals

Both petitioner and respondent appealed to the Court of Appeals for the Seventh Circuit. Prior to the decision of the Court of Appeals for the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 420 U.S. 923 (1975), Gulf & Western principally argued that Section 16(b) did not apply to the purchases and sale involved in this case, relying on the decision of this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

After the decision of the Ninth Circuit, Gulf & Western contended that it was not liable under Section 16(b) for profits realized on the sale of the initial 3,000,000 shares of Allis-Chalmers stock it purchased in July and sold in December 1968. Gulf & Western's position was that because it owned no such stock prior to its exchange offer purchase, it was not a beneficial owner "both at the time of the purchase and sale" and therefore was exempt under the proviso of Section 16(b) from liability for the short-swing profits that it had realized.

The Court of Appeals for the Seventh Circuit relied heavily on the decision of the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 420 U.S. 923 (1975), as well as the language of a Senate bill that was left aside in favor of the present Section 16(b). The Seventh Circuit held that Section 16(b) only applies to "beneficial owners" who, after already owning 10% of the securities of an issuer, thereafter realize profits from the purchase and sale within six months of additional shares. The Court, as noted above, candidly acknowledged "that a contrary view

has been taken in the Second and Eighth Circuits" and that "a conflict between circuits exists." 6a n.5.

Respondent further argued to the Seventh Circuit that its second purchase of stock (from Oppenheimer) on September 30, 1968 was such an integral part of the original exchange offer that the test utilized by this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), must be applied and that respondent should not be liable for the short-swing profits realized from the purchase and sale of that block of stock. The Court of Appeals rejected this contention, holding that the Oppenheimer transaction was neither "an unorthodox transaction" nor devoid of the possibility of speculative abuse.

Petitioner Allis-Chalmers appealed to the Seventh Circuit on the ground that the District Court had improperly calculated the extent of respondent's short-swing profits. The Court of Appeals agreed, holding after detailed analysis of the evidence that respondent had in fact realized profits of $2,465,680.47 from the purchase from Oppenheimer and sale to White of the block of 248,000 shares of Allis-Chalmers stock.

**Reasons for Granting a Writ of Certiorari**

A writ of certiorari should issue to review the judgment of the Court of Appeals for the Seventh Circuit because that court has rendered a decision which conflicts with decisions of the Courts of Appeals for the Second and Eighth Circuits. The importance of this federal question, concerning the applicability or inapplicability of this remedial statute to far from unusual circumstances, cannot be contested in view of the grant of a writ of certiorari in

*Foremost-McKesson, Inc.* v. *Provident Securities, Inc.*, 420 U.S. 923 (1975).

Prior to the decision of the Court of Appeals herein, both Allis-Chalmers and Gulf & Western moved for and were granted leave by this Court to file briefs *amici curiae* in support, respectively, of petitioner's petition for certiorari and respondent's opposition thereto in *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, Docket No. 74-742. While the question presented by the instant petition is likely to be decided in *Foremost-McKesson,* that case may involve the resolution of additional questions not here presented. Allis-Chalmers' motion for leave to file an *amicus* brief is included herein as Appendix C.

The narrow question presented here is the construction of the phrase "at the time of" in the exemption for "beneficial owners" provided in Section 16(b). Simply stated, the question is whether a person must first own 10% of the securities of an issuer and then purchase and sell additional shares within six months before short-swing profits must be disgorged. The plain statement of this discrete question completely conceals, however, the profoundly broad practical impact that its resolution encompasses. Does this "prophylactic" statute preclude an issuer from recovering approximately $10,000,000 of short-swing profits realized from the purchase and sale within six months of 29% of the listed securities for the calculated or fortuitous reason that the beneficial owner purchased all such stock in one transaction?

If there is any concern as to what Congress did mean when it limited the coverage of the statute to situations where the beneficial owner is a 10% owner "both at the time of the purchase and sale, or the sale and purchase", Allis-Chalmers suggests that this Court supplied the answer in

*Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 423 n.3 (1972). There this Court cites with approval 2 L. Loss, Securities Regulation 1060 (2d ed., 1961) with respect to step sales. Professor Loss' full text covers both step purchases and step sales.

> "A substantial 'out' nevertheless remains for the 10 percent holder: If a person who is not an insider wants to acquire up to, say, 15 percent, he should buy up to just under 10 percent in one transaction (which will be exempted even under the court's construction [in *Stella* v. *Graham-Paige Motors Corp.*, *infra*]) and then buy the remaining 5-plus percent in a separate transaction. Conversely, a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder."

As recognized by the Court of Appeals in the instant case, the Second Circuit consistently has held for 19 years that "at the time of" does not mean "prior to" but "simultaneously with", and that a person is a "beneficial owner" "at the time of" the purchase if more than 10% of a class of registered equity securities are purchased. This construction was first applied in *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957 (S.D.N.Y. 1952), *aff'd on this point*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). To construe "at the time of" as meaning "prior to" would permit exactly the type of "in and out" profit-taking Section 16(b) was intended to prevent and that has occurred in this case.

The reasons favoring such a construction of Section 16(b) obviously promote the purpose of the 1934 Act. As

stated by the Chief Justice in *Adler* v. *Klawans*, 267 F.2d 840 (2d Cir. 1959):

> "Most recently in Stella v. Graham-Paige Motors Corp., supra, this court gave approval to the District Court's holding that the purchase which makes a person a 10% beneficial owner may be included notwithstanding the express proviso. All three of these cases underscored, either expressly or impliedly, Judge Clark's statement in the Smolowe case that:
>
> > 'The statute is broadly remedial. Cf. Wright v. Securities and Exchange Commission, 2 Cir., 112 F.2d 89. Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.'" 267 F.2d at 846 (footnote omitted).

The Second Circuit has consistently followed this construction of the phrase "at the time of". *Perine* v. *William Norton & Co.*, 509 F.2d 114, 118 (2d Cir. 1974); *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 355-56 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970).

The holding of *Stella* was adopted by the Eighth Circuit in *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972). The Court of Appeals there observed that:

> "[a]ny other view [of the meaning of the phrase 'at the time of'] has the weakness of impracticability of appli-

> cation of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." 434 F.2d at 924.

Despite this Court's observation that "the legislative history [of Section 16(b)] affords no explanation of the purpose of the proviso", *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972), the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 420 U.S. 923 (1975), purported to find legislative history supporting a construction of "at the time of" as meaning "prior to". As set forth fully in Allis-Chalmers' brief as *amicus curiae* in support of Foremost-McKesson, Inc.'s petition for a writ of certiorari, reproduced in Appendix C hereto, the Ninth Circuit reached this conclusion on the basis of language contained in a Senate bill which was never enacted. As shown in Allis-Chalmers' *amicus* brief, the legislative history of the House bill, which was the lineal predecessor of Section 16(b), supports petitioner's position. The House bill was introduced almost a month *after* the hearings on a Senate bill upon which the Ninth Circuit erroneously relied in reaching its construction of the proviso of Section 16(b). See 87a-92a.

In the present case, the Seventh Circuit stated that it agreed with much of the Ninth Circuit's analysis of the legislative history, thereby perpetuating that Court's erroneous construction of Section 16(b). 15a-19a. Allis-Chalmers submits that, to the extent relevant legislative

history exists, it supports the position of the Second and Eighth Circuits that Congress intended to bar an insider from retaining the type of short-swing profits realized here by Gulf & Western.

As is obvious from the facts of this case, Gulf & Western's reliance on *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), is entirely misplaced. That the decision therein, involving an involuntary, forced disposition of the shares as part of a corporate reorganization, is inapposite requires no extended comment. Even the Court of Appeals for the Seventh Circuit, in the present case pointed out that Gulf & Western

> "voluntarily disposed of the [Allis-Chalmers] shares within six months, *after* obtaining an indication from Allis-Chalmers' chairman that the future of that company did not look any too bright. The possibility clearly existed, therefore, that Gulf & Western's early disposition of its Allis-Chalmers shares was an attempt to avoid the effect of the predicted weakening of Allis-Chalmers' common stock, a prediction gained as an insider of that company." 24a (emphasis in original).

This Court stated in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972):

> "To be sure, where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders". (Footnote omitted.)

Clearly the situation in which a corporation makes an initial purchase of almost 29% of the common stock of

another and sells the entire block within six months at a handsome profit constitutes exactly the opportunity for short-term speculation Congress intended to prevent by enacting Section 16(b). The applicability of Section 16(b) would be severely if not fatally curtailed with respect to a variety of situations in which Congress attempted by means of a flat rule to prevent the *possibility* of "the unfair use of information". The construction of Section 16(b) adopted by the Courts of Appeals for the Seventh and Ninth Circuits not only does plain violence to the Congressional purpose underlying Section 16(b) but cannot logically be found in the statute or gleaned from the legislative history. The conflict among the Courts of Appeals over the construction of a statute prescribing important national policy must, and can only be, resolved by this Court.

## CONCLUSION

For the reasons set forth above, petitioner Allis-Chalmers Manufacturing Company prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit, or, in the alternative, that this Court withhold action on this petition pending the decision of this Court in *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, Docket No. 74-742, and thereafter dispose of this petition in accordance with any decision therein which may control the issue presented by this petition.

Dated: October 16, 1975

Respectfully submitted,

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